

STATE OF CALIFORNIA
NOTICE OF WORKSHOP
SPONSORED BY THE RESOURCES AGENCY

In the matter of:

Preparation for the Governor's Potential
Decisions on Offshore LNG Import Terminal
Applications

Energy Commission
Docket No. 05-LNG-1

**POST-WORKSHOP COMMENTS OF
SHELL TRADING GAS & POWER**

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In accordance with the "Notice of Public Workshop on LNG Access Issues and Deliverability of Supply" that was issued in the above-referenced docket on May 13, 2005, Shell Trading Gas & Power ("Shell") files brief comments on the workshop that was held on June 1 and 2, 2005. As one of the world's largest shippers of LNG and as a capacity holder in Sempra LNG's Costa Azul LNG project in Baja California, Shell and its affiliates have a direct interest in California's consideration of issues related to LNG imports.

The May 13 Workshop Notice indicated that the workshop was "intended to facilitate a discussion on the terms of access to LNG re-gasification services at offshore terminal facilities. . . ." Notice at p.1. Because the Sempra LNG facility is an onshore facility, Shell did not make a presentation at the workshop. However, Shell appreciates the opportunity to file these comments on security of supply and access issues relative to the California market.

Shell understands that the Energy Commission (“Commission”) and the Resources Agency plan to host further workshops on LNG issues later this year. Depending upon the subjects to be addressed at the future workshops, Shell welcomes the opportunity to contribute to these workshops, as well.

Shell will comment herein on two issues that were raised during the workshop on June 1 and 2. First, Shell will address the security and reliability of LNG supplies delivered through the Costa Azul re-gasification facility in Baja California to points of interconnection with SoCalGas and SDG&E at the California border. Second, Shell will discuss the consequences of continued uncertainty respecting terms and conditions of access to the California market for Baja LNG supplies.

As to the matter of security and reliability of supply, Shell wishes to advise the Commission and other State authorities, as well as the gas utilities and other core and noncore gas purchasers, that LNG supplies processed at the Costa Azul re-gasification facility in Baja California will provide the same level of security and reliability as any existing or future in-state or interstate gas supplies that may be delivered to the California market. Specifically, there are no legal or regulatory impediments in Mexico that would prevent the reliable delivery of gas from Costa Azul to the California border for sale to wholesale or retail customers in California. In fact, the presence of the LNG import terminal in Baja California creates the possibility of significantly improving California’s gas supply security and reliability by providing an alternative long term source of gas supply for California customers.

With respect to the terms and conditions of access for Baja LNG supplies, Shell wishes to make the State’s regulatory authorities aware that delays in establishing the terms of access to the California market are placing all providers of new gas supplies, including but not limited to

LNG suppliers, at a competitive disadvantage compared to existing gas suppliers. This continued uncertainty prevents new suppliers from entering into contracts with gas purchase customers, including the gas utilities. In particular, this uncertainty prevents LNG suppliers from entering into contracts that may be considered under the “pre-approval” process that was adopted in PUC Decision 04-09-022 (September 2, 2004).

For example, delays have occurred in the PUC’s consideration of interconnection agreements and other “standardized” agreements for the construction of interconnection facilities. Delays have occurred in the PUC’s consideration of “system integration” for the SoCalGas and SDG&E transmission systems. Delays have prevented the establishment of definitive gas quality specifications for new gas supplies. And delays have forestalled a determination on the interconnect access rights for shippers that have agreed to pay for expansions of interconnect capacity. These matters are addressed in more detail below.

I.

SHELL’S INTEREST IN THIS PROCEEDING

Shell affiliate Coral Energy Resources, L.P. (“Coral”) has acquired 500 MMcf/day of gas off-take from Sempra LNG’s 1 Bcf/day Costa Azul LNG import facility located in Baja California. Construction of the Costa Azul facility commenced in January 2005 and the facility is scheduled to begin receiving LNG supplies in December 2007. A substantial portion of Coral’s gas supply from the Costa Azul facility could be delivered to the California market.

Shell’s LNG supplies will be delivered to the Costa Azul re-gasification facility from gas fields in the Asia Pacific region, including Shell’s production facilities on Sakhalin Island offshore the mainland of Russia, Shell’s equity production from the Gorgon field in Australia, and from other fields in the Pacific Rim area.

Shell has a direct and substantial interest in the terms and conditions of access for new natural gas supplies delivered to the California market. Through its significant investment in the facilities that Shell is developing in the Pacific Rim and Baja California, including state-of-the-art LNG tankers, Shell intends to provide secure and reliable gas supplies to markets in Mexico and the southwest United States. Shell submits that the terms and conditions of access that are developed by California's regulatory agencies will determine the extent to which Shell's secure and reliable gas supply can be delivered to customers in California.

II.

SHELL'S GAS SUPPLIES WILL BE SECURE AND RELIABLE

Shell responds herein to the claim that LNG supplies delivered via onshore re-gasification facilities in Mexico will not be as secure and reliable as gas supplies originating from or delivered through other North American points of entry. Shell wishes to assure the State agencies that LNG delivered to the Costa Azul re-gasification facility and through pipelines to the California border will provide a reliable and dependable source of supply for those California gas customers that enter into contracts for the purchase of this gas supply.

As a threshold matter, the Commission must understand that the re-gasified LNG delivered from the Costa Azul facility to the California border is just like any other gas supply. The security and reliability of this new gas supply, like any other gas supply, will be addressed through the gas sale contracts that are entered into between sellers and buyers. For example, if Coral enters into a contract providing for the firm supply of gas to SoCalGas for SoCalGas' core supply portfolio, Coral will be responsible for providing a firm supply of gas, whether the gas originates in Canada, Wyoming, or Russia. The parties will allocate the risks of supply interruptions or transportation interruptions that occur upstream - - and downstream - - of the

delivery point, including obligations to provide make-up gas and/or money damages for replacement gas, as is customary in gas sale and purchase agreements in North America. These matters can and will be worked out through negotiated contracts. For specific contracts between a supplier of re-gasified LNG and a gas utility (for the utility's core portfolio), the PUC will have the opportunity to review the allocation of risk through the pre-approval process that was adopted in by the PUC in D.04-09-022 (September 2, 2004).

That the re-gasified LNG is delivered to the California market from facilities and pipelines in Mexico does not diminish the reliability of the gas supply. There are no provisions in the Costa Azul facility license that would enable the Mexican government to restrict the services provided by the facility. The Mexican government's authority to revoke or suspend the Costa Azul license is no broader than the U.S. government's authority to revoke or suspend a license granted to a U.S. facility.

Moreover, Mexican law provides for the transportation of gas within Mexico and for the importation and exportation of gas into and from Mexico. Once again, under Mexican law, the government cannot revoke a license granted to a transporter except under extremely limited conditions (i.e., conditions analogous to those that apply under a certificate granted to a U.S. interstate pipeline). Mexico's Foreign Trade Act does not impose limits on the exportation of gas from Mexico, or on the importation of gas into Mexico.

Based on the foregoing, California regulatory agencies can be assured that LNG supplies processed at the Costa Azul facility and delivered to the California border will be secure and reliable, consistent with other gas supplies delivered to the California border. Contracts between gas suppliers and gas purchasers in California will determine the nature of the gas supply obligation. If the gas supply contract is an "LNG-specific" agreement, the LNG supply will

serve as a reliable source of supply for the California customer, and in fact will provide an alternative source of supply that reduces, rather than increases supply risk owing to the diversification of the State's gas supplies.

III.

DELAYS IN DETERMINING THE TERMS OF ACCESS FOR OTAY MESA DELIVERIES CREATE UNCERTAINTY FOR LNG SUPPLIERS

During the workshop, a representative of TransCanada reported that two shippers that will be using the Costa Azul re-gasification facility have executed transportation contracts with North Baja Pipeline, Baja Norte and TGN. The TransCanada representative also reported that as a result of these contracts, North Baja Pipeline would be importing up to 900 MMcf/day (plus) on a peak day from Mexico. He stated that this gas would be delivered either to SoCalGas at Blythe, or to El Paso at Ehrenberg, or both.

As Shell and Coral have stated previously in comments to the PUC, the preferred path for re-gasified LNG that is delivered to the California market is through a new Otay Mesa receipt point.¹ Unfortunately, due to a series of delays in ongoing PUC proceedings in which the terms of access for new natural gas supplies are being addressed, there exists great uncertainty regarding the rates, terms and conditions for suppliers that seek to deliver their gas to California customers through the Otay Mesa receipt point.

Due to the delays in various PUC "access" proceedings, LNG suppliers have been forced to pursue other transportation alternatives (i.e. transportation on the Baja Norte and North Baja pipelines) in order to ensure that their gas supplies, once delivered to the Costa Azul facility, can be delivered to end-use customers on an economic basis. As Coral has indicated in previous

¹ See R.04-01-025, "Opening Comments of Coral Energy Resources, L.P. on the Presiding Judges' Phase I Draft Decision," p. 2 (filed August 9, 2004).

comments to the PUC, obtaining transportation on the Baja Norte and North Baja pipelines will make it more likely that the Costa Azul LNG supplies will be sold to markets outside of California.²

Shell urges the State agencies to work collaboratively to accelerate the PUC proceedings in which the terms of access at Otay Mesa will be established. At this time, key access issues that must be considered at the PUC include: a) “system integration” (whether SoCalGas and SDG&E’s gas transmission systems should be economically integrated for purposes of gas deliveries to southern California receipt points) (this issue is being considered in PUC Docket No. A.04-12-004); b) the terms and conditions under capacity upgrade agreements, interconnection agreements, and operational balancing agreements for construction and operation of facilities at new southern California receipt points (some of the agreements are being addressed in Phase II of R.04-01-025, while others are being addressed through SoCalGas and SDG&E “advice letters”); c) gas quality, which is being addressed in Phase II of R.04-01-025 (in conjunction with the Commission), but also is being considered separately by the Air Resources Board; and d) the nature of the access rights for shippers that pay for an expansion of the utility’s receipt point capacity to accommodate new gas supplies (this issue has not yet been considered by the PUC).

All of the foregoing issues must be resolved expeditiously in order to provide LNG suppliers with the certainty that is necessary to enter into contracts for the sale of gas to California customers. Unfortunately, the current schedules in these proceedings (with the exception of proceedings involving standardized construction and interconnection agreements) make it unlikely that final PUC decisions will be issued by the end of this calendar year.

² See R.04-01-025, “Reply Comments of Coral Energy Resources, L.P. on Phase I Proposals,” pp. 12-13, 15 (filed April 6, 2004).

Delays in determining the terms and conditions of new supplier access to the California market have prevented LNG suppliers and the gas utilities from participating in the “contract pre-approval” process that was adopted by the PUC in Decision 04-09-022. SoCalGas and PG&E already have been granted pre-approval for contracts for firm interstate capacity on existing pipelines.³ Until the PUC resolves the terms and conditions of access for new gas supplies, however, LNG suppliers will not be able to participate in that process. It is for this reason that Shell has entered into precedent agreements for firm capacity on the Baja Norte and North Baja pipelines. Unless and until the terms and conditions for access to the California market (and specifically to the Otay Mesa receipt point) are resolved, Baja LNG suppliers must proceed with plans to market and deliver their gas supplies to customers outside of California.

IV.

CONCLUSION

The permits and licenses granted by the Mexican government for the Costa Azul re-gasification facility ensure that gas deliveries from the Costa Azul facility - - and exports to the U.S. market - - will be as secure and reliable as supplies delivered to points in the U.S. Contracts between suppliers and California customers will determine the firmness of the gas supply and will allocate the risk of possible supply and/or transportation interruptions between the parties.

With the Costa Azul re-gasification facility scheduled to commence operations in December 2007, Shell and its affiliates are ready and willing to begin the process of negotiating contracts for the sale of gas, including but not limited to LNG-sourced supplies, to California customers. In order for contracts to be offered and negotiated, however, the terms and conditions

³ See SoCalGas Advice No. 3462 (filed February 2, 2005) (Transwestern capacity contracts); PG&E Advice No. 2624-G (filed April 18, 2005) (El Paso capacity contracts).

of access to the California market - - in particular, the terms and conditions of access to Otay Mesa - - must be finally established by the PUC.

In view of the obligations that otherwise must be undertaken with respect to alternate pipeline transportation, Shell urges the State's regulatory agencies, including in particular the PUC, to issue definitive decisions by the end of this year, if not sooner, on system integration, gas quality, interconnect access rights for shippers that pay for interconnect capacity expansions, and the terms of a pro forma operational balancing agreement. A final PUC decision on expansion facility construction and interconnection agreements should be issued by August 31, 2005.

Respectfully submitted,

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